LOCKHEED MARTIN

Volume 1,Issue 4 June 30, 1999

Your Savings Program

More Information?
Call 1-888-ISAVEIT

Let's Talk Again About Taxes!!!

The whole idea about a qualified savings program is that it has special tax advantages that a private savings program does not. Let's look at the tax features of our plans and talk about the tax traps we might encounter.

The Savings Program has two distinct features, a pre-tax feature governed by Section 401(k) of the Internal Revenue Code and an after tax feature governed by Section 401(a) of the Internal Revenue Code. Let's examine the after tax features first. It is called "after-tax" because the employee contributions are taken from compensation that is subject to current year taxation. If you choose to contribute six percent of your compensation on an after tax basis, all of your current compensation would be subject to income taxes in the year in which it is paid and contributions to the Program would be made from the funds left over after income taxes are withheld. What is

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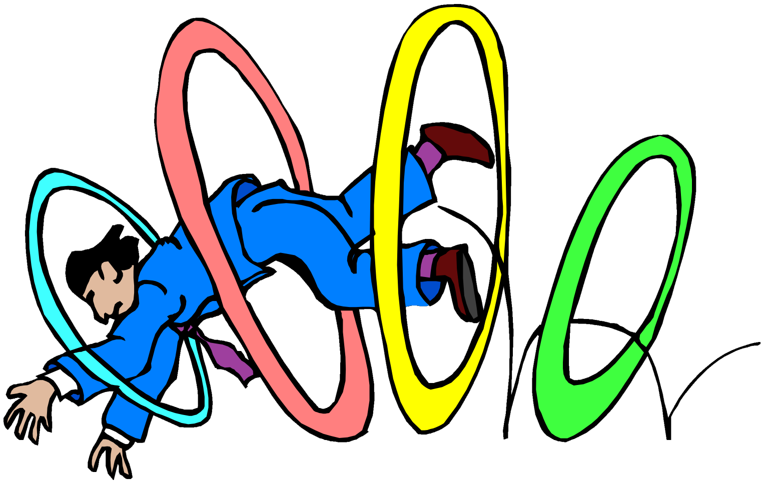
Savings Power-A Key to Financial Security

And Then There Was One

After several years of operating with multiple plans, the legacy plans for the collective bargaining units have been transferred to the new Savings Program. Welcome!



the tax advantage? You don't have to pay income taxes on the Company matching contribution on that six percent plus all the earnings on the employee contributions and the employer contributions until the funds are taken out of the Program. You are deferring taxes to a later date. This deferral of taxes provides a significant advantage over non-qualified savings programs on which you must pay taxes on the earnings each year. Since you paid taxes on the income from which the contributions were made, you don't have to pay taxes on the employee contributions when they are removed from the plan.

An even more exciting part of the Program is the ability to make contributions on a "pre-tax" basis. Essentially what this means, is rather than taking a portion of your compensation in cash, you may elect to have a portion contributed to the Savings Program on your behalf. This "cash or deferred option" allows the participant to defer taxes on compensation as well as deferring taxes on the Company matching contributions and any earnings on all contributions while they are in the plan. This feature has been described as the last best tax advantage for individuals.

You make the decisions about how your contributions are made. You may elect to have all your contributions made with after-tax dollars or you may elect to have all your contributions made with pre-tax dollars. You may also choose to have a combination. The current limit is fifteen percent of your eligible earnings. You may check on your current contribution elections and make new elections by calling the toll free number.

We have only discussed how the plan defers taxes. All good things must come to an end. The IRS doesn't wait forever to get its taxes. When funds are withdrawn from the Savings Program calculations must be prepared to determine what part of the distribution is a return of after-tax employee contributions and what part of the withdrawal is taxable income. A withdrawal of anything other than after-tax employee contributions is treated as taxable income and that includes company matching contributions, earnings on the after tax contributions (employer and employee), all pre-tax contributions (employer and employee), and all earnings on pre-tax contributions. The record keeping system is designed to keep track of all these types of funds by their source and the system can accurately determine the taxable portion of any distribution.

That in itself would be complicated enough, but you know the IRS. When a participant makes a withdrawal of after-tax employee contributions that were made before 1987 (your "grandfathered" money), these contributions may be distributed without any tax consequence. However, a withdrawal of after-tax contributions that were made after 1986 must be accompanied by a proportionate amount of employer matching and earnings dollars. What this really means is that even if you are withdrawing after-tax contributions, you will also be withdrawing company matching funds and earnings and therefore the distribution will have a tax impact. The record keeping system has a built-in calculation to provide you an estimate of the taxable portion of each withdrawal or distribution request. All pre-tax dollars are taxable when withdrawn or distributed, including the company match and the earnings. Remember, withdrawals of pre-tax money are severely restricted. It is usually available only after achieving age 59 1/2 or upon separation from service. Hardship withdrawals are available that would allow you to take pre-tax funds out of the plan, but you can't avoid the taxes.

Worse yet, to discourage the withdrawal or distribution of qualified plan dollars, the IRS not only imposes taxes on the distribution but also imposes a penalty tax for pre-mature distributions. A pre-mature distribution occurs if the distribution is made before you are 59 1/2. This ten percent excise tax is in addition to regular income taxes. This pen-

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alty tax applies to a pre-mature distribution of all taxable amounts, including earnings on after-tax contributions. There are exceptions to the penalty tax and they are discussed in the special tax notice sent with your statements. Above and beyond these exceptions, it is possible to avoid the income tax and penalty tax on withdrawals and distributions by redirecting the taxable part of the distribution to another qualified plan or an Individual Retirement Account. This redirection process is call a "roll-over" and it effectively defers the taxes until the funds are subsequently withdrawn from the second plan. If you are contemplating a "roll-over," keep in mind that only the taxable portion of a withdrawal or a distribution my be treated this way. You cannot "roll- over" a return of after-tax employee contributions. Talk to your IRA custodian before you attempt a rollover distribution.

Complicated enough? There is more. There are special rules about withholding and In a special approach to "you can't take it with you," the Internal Revenue Code has a whole section about insisting that you start withdrawing funds and paying taxes once you reach age 70 1/2. We will discuss these issues in another letter. The rules governing the taxability of withdrawals and distributions are sufficiently complicated that no one should make a withdrawal or distribution without consulting the following:

1) The Employee Handbook
2) The Special Tax Notice that is included in your quarterly statements.
3) The instruction booklet for your Form 1040 and
4) The IRS Publications on Individual Tax Returns and Pension Income.

If your withdrawal or distribution is large, it may be to your advantage to consult a tax professional before making your final decision. You can obtain information about what is available for withdrawal and what amount of the distribution will be subject to tax by calling the toll free number.

You finish first with a solid personal financial plan.

Keep in Touch, Contact Benefits Administration by Sending an E-mail to ik5@ornl.gov or calling 1-423-574-9564